Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of		
	)	
Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers	))	**RM-10822**
	)	
Federal-State Joint Board on Universal Service	))	**CC Docket No. 96-45**

MCI COMMENTS

WorldCom, Inc. d/b/a MCI (MCI) hereby submits its comments on the Petition for Rulemaking filed by Western Wireless Corporation (Western Wireless) on October 30, 2003. MCI fully supports Western Wireless's request that the Commission expedite the development of a modernized rate regulation and universal service system for rate of return carriers.

The need for a modernized system of regulation is particularly urgent because of the uncertainty surrounding the enforceability of rate of return regulation. Since the D.C. Circuit's decision in ACS v. FCC,[1] many rate of return carriers have taken the position that section 204(a)(3) of the Communications Act may preclude the award of damages even in those instances where the carrier has overearned, i.e., has violated its rate of return prescription. If those rate of return LECs' interpretation of section 204(a)(3) were to be confirmed, then rate of return regulation will have collapsed because the rate of return prescription would be unenforceable: rate of return carriers would apparently be able to retain all of their earnings, even if those earnings exceeded the amount permitted by the prescribed rate of return. If the rate of return prescription is unenforceable, the Commission is obliged to develop an alternate form of regulation in order to ensure that incumbent LEC rates are just and reasonable.

Even if there were no uncertainty surrounding the application of section 204(a)(3) in the context of rate of return regulation, immediate action to address the issues raised by Western Wireless would be required. With respect to access charges, it has been over two years since the Commission recognized the potential benefits of transitioning rate of return carriers to incentive regulation by issuing a Notice of Proposed Rulemaking in CC Docket No. 00-256. And, with respect to universal service issues, the Commission should be working to develop a forward-looking cost based universal service support system to put in place when the RTF rules expire in mid-2006.

As Western Wireless explains, transitioning rate of return carriers to incentive regulation is necessary for several reasons. First, an incentive-based scheme would avoid the inflation of LEC rates that results from inadequate scrutiny of rate of return carriers' accounting information. Most of today's rate of return LECs are smaller carriers that are not required to report detailed cost information through ARMIS. And, because most rate of return carriers participate in the NECA pool, individual carriers' costs are not scrutinized by the Commission in the tariff review process, in contrast to the detailed review that the Commission applied to the larger ILECs' annual access filings in the 1980s. Of particular concern is the absence of any review of rate of return carriers' compliance with the Commission's cost allocation rules. In recent years, rate of return carriers have increasingly begun to operate in markets outside their core, regulated local exchange businesses, by providing Internet access services or operating

[1] ACS of Anchorage, Inc. v. FCC, 290 F.3d 403 (D.C. Cir. 2002).

as CLECs outside their service areas. In the absence of detailed scrutiny of rate of return carriers' books, there can be no assurance that the costs associated with those carriers' growing competitive operations are excluded from the reported revenue requirement.

Second, a properly-designed incentive regulation scheme would encourage rural LECs to operate more efficiently, to the benefit of consumers. For example, a properly-designed incentive regulation system may encourage more widespread use of wireless technologies by incumbent LECs in high-cost areas. And a more rational regulatory scheme would eliminate artificial incentives for the large price cap LECs to sell exchanges to smaller companies, and would create incentives for the consolidation of rural LECs serving contiguous areas, with resulting efficiency gains from economies of scale.

The current rules not only contribute to inflated interstate and intrastate rates, but inflate the size of the universal service fund as well. Both of the high-cost mechanisms available to rate of return carriers determine universal service support using book costs that reflect the inefficiencies and rate base and expense "padding" that occur under rate of return regulation.

As MCI explained in its comments on the 2001 Further Notice of Proposed Rulemaking in CC Docket No. 00-256, MCI advocates transitioning rate of return carriers to price cap regulation, beginning with the larger holding companies. There is clear evidence that at least the larger holding companies can operate successfully under an incentive regulation scheme, even when those lines are spread across several study areas or the study areas qualify as "rural:" Valor, Iowa Telecom, and Citizens have all operated successfully under price cap regulation for several years.

The new regulatory scheme for today's rate of return carriers should be based on the existing price cap rules, and should include an X-factor equal to GDP-PI plus a consumer productivity divided of 0.5 percent. Because, however, the Commission could not be certain that an X-factor set in this manner is accurate for rate of return LECs generally or for individual LECs, the Commission should adopt a "backstop" sharing mechanism modeled on the sharing plan adopted in the LEC Price Cap Order to ensure that "consumers receive their fair share of the productivity gains that will occur, just as they would in an industry with keener competition."[2]

In addition to reform of the rate regulation system, the Commission should, as Western Wireless advocates, move expeditiously to develop a forward-looking cost based universal service support system. The Commission committed to a forward-looking cost based system in 1997, and reaffirmed that commitment in 2001. Because the temporary extension of embedded cost-based support is due to expire in 2006, the Commission should begin working now to resolve any issues associated with developing a forward-looking cost based scheme.

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[2] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6801 (1990) (LEC Price Cap Order).

For the reasons stated herein, the Commission should transition rate of return carriers to an incentive regulation scheme and develop a forward-looking cost based universal service approach for rural carriers, as advocated by Western Wireless.

Respectfully submitted,
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